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TOKYO, JAPAN

September 30, 1993

BY HAND

Mr. William F. Caton
Acting Secretary
Federal Communications Commission
1919 M Street, N.W.
Washington, D.C. 20554

Re: Rate Regulation
Third Notice of Proposed Rulemaking
MM Docket No. 92-266

Dear Mr. Caton:

Please find attached on behalf of the National Association of Telecommunications Officers and Advisors, et al., an original and eleven copies of the Comments of the National Association of Telecommunications Officers and Advisors, et al., in the above-referenced proceeding.

Any questions regarding the submission should be referred to the undersigned.

Sincerely,

Bruce A. Henoch

Bruce A. Henoch

Attachment

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992 Rate Regulation	MM Docket No. 92-266

TO: The Commission

COMMENTS OF THE NATIONAL ASSOCIATION OF TELECOMMUNICATIONS OFFICERS AND ADVISORS, THE NATIONAL LEAGUE OF CITIES, THE UNITED STATES CONFERENCE OF MAYORS, AND THE NATIONAL ASSOCIATION OF COUNTIES IN RESPONSE TO THE THIRD NOTICE OF PROPOSED RULEMAKING

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September 30, 1993

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SUMMARY

The Commission should proceed with two major statutory goals in this proceeding in mind: (1) to ensure that cable subscribers pay "reasonable" competitive rates for cable service, see, e.g., 47 U.S.C. § 543(b)(1); and (2) to adopt rules that are administratively simple and not burdensome for the Commission and franchising authorities to implement, see, e.g., 47 U.S.C. § 543(b)(2)(A).

With these goals in mind, Local Governments believe that all cable operators should be treated the same with regard to the recovery of upgrade costs -- regardless of whether such upgrades are undertaken in response to a franchise requirement or completed prior to the commencement of federal rate regulation. In addition, upgrade costs should never be treated as "external" costs. Instead, upgrade costs should be recoverable only pursuant to a cost-of-service showing, and only in exceptional circumstances.

The Local Governments agree with the Commission's tentative conclusion that a cable operator should be required to use the same method of rate regulation (benchmark or cost-of-service) in proceedings before the Commission and a franchising authority. The Commission should adopt regulations that facilitate the sharing of information between the Commission and a franchising authority with regard to the review of such a cable operator's rates. However, Local Governments strongly

oppose a requirement that would make a decision by the Commission binding on a franchising authority, or vice versa.

The Local Governments agree that the Commission should adopt rules to ensure that capped cable rates remain "reasonable" after a cable operator adds or deletes channels. However, the Commission should adopt a rule that ensures reasonable rates and is easy for the Commission and franchising authorities to administer.

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FEDERAL COMMUNICATIONS COMMISSION
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The National Association of Telecommunications Officers and Advisors, the National League of Cities, the United States Conference of Mayors, and the National Association of Counties (collectively, the "Local Governments") hereby submit these comments in the above-captioned proceeding.

INTRODUCTION

The Federal Communications Commission ("Commission") requests comments on: (1) whether it should treat as an "external" cost not subject to the price cap the cost of an upgrade to a cable system

required by a franchising authority; (2) whether cable operators should be required to use the same method of rate regulation (benchmark or cost-of-service) in rate proceedings before the Commission and franchising authorities; (3) whether cable operators that completed upgrades immediately prior to implementation of the Commission's rate rules, and that have rates below the benchmark rate, should be able to raise their rates to the benchmark rate; and (4) how to adjust a capped rate to reflect the addition or deletion of channels. With regard to each of these issues, the Commission should proceed with two major statutory goals in this proceeding in mind: (1) to ensure that cable subscribers pay "reasonable" competitive rates for cable service, see, e.g., 47 U.S.C. § 543(b)(1); and (2) to adopt rules that are administratively simple and not burdensome for the Commission and franchising authorities to implement, see, e.g., 47 U.S.C. § 543(b)(2)(A).

As explained more fully below, all cable operators should be treated the same with regard to the recovery of upgrade costs -- regardless of whether such upgrades are undertaken in response to a franchise requirement or completed prior to the commencement of federal rate regulation. In addition, upgrade costs should never be treated as "external" costs. Instead,

upgrade costs should be recoverable only pursuant to a cost-of-service showing, and only in the exceptional circumstances described below.

The Local Governments agree with the Commission's tentative conclusion that a cable operator should be required to use the same method of rate regulation (benchmark or cost-of-service) in proceedings before the Commission and a franchising authority. The Commission should adopt regulations that facilitate the sharing of information between the Commission and a franchising authority with regard to the review of such a cable operator's rates. However, Local Governments strongly oppose a requirement that would make a decision by the Commission binding on a franchising authority, or vice versa.

The Local Governments agree that the Commission should adopt rules to ensure that capped cable rates remain "reasonable" after a cable operator adds or deletes channels. However, the Commission should adopt a rule that ensures reasonable rates and is easy for the Commission and franchising authorities to administer.

DISCUSSION

I. Upgrade Costs Should Be Treated The Same, Regardless of Whether Required by a Franchise or Incurred Prior to Rate Regulation

As discussed more fully in Section II of these Comments, the Local Governments believe that upgrade costs should be recovered only in exceptional circumstances through cost-of-service showings, and not through external cost adjustments. In particular, Local Governments strongly oppose a requirement that would permit cable operators to treat as external costs upgrades required by local franchising authorities.[1]

Cable subscribers in a franchise area where a franchising authority attempted to protect subscribers' interests by negotiating an upgrade requirement in a franchise should not have to pay higher rates than subscribers in a franchise area where a cable operator voluntarily undertook an upgrade. There is no rational basis for the distinction in treatment.

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[1] Similarly, upgrades that are required in order for the system to meet federal minimum requirements -- such as technical standards -- should not have an impact on rates. Operators that are required to perform such upgrades in order to provide a minimum level of service should not be permitted to then pass these costs along to subscribers. Expenditures that are needed in order to meet these types of minimum requirements at the federal, state or local level should in no way be considered external costs.

The unfairness of such a distinction is most apparent if one considers a single cable system that serves multiple franchise areas. The cable operator of the system may have entered into franchise agreements with several franchising authorities that require an upgrade. Other franchising authorities in jurisdictions served by the system may have decided not to include an upgrade requirement in their franchises with the cable operator. In order to comply with the upgrade requirement in a few franchises, the cable operator probably would upgrade its entire system. Or, the cable operator may have upgraded the cable system even without any requirement to do so in order to provide additional revenue-enhancing services over its system, such as per-view and per-channel programming, and non-cable services.[2] Regardless of the incentive for the upgrade, the result would be that the cable operator could pass on part of the upgrade cost as an "external" cost to those subscribers in jurisdictions with the upgrade franchise requirement, while such costs could not be passed on to subscribers in jurisdictions without the franchise requirement. Congress did not intend for the

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[2] As explained below, upgrade costs for such services should only be recoverable from the subscribers to such services, and only in exceptional circumstances.

Commission to engage in such arbitrary distinctions for purposes of rate regulation.

In addition, many franchise agreements do not have clear and specific "upgrade" requirements which define a cable operator's upgrade obligations. A franchise agreement may simply require a cable system to maintain a "state-of-the-art" cable system during the franchise term, or to take other upgrade actions to ensure that cable subscribers continue to receive the level of service most modern cable systems provide. Upgrade requirements may not be more specific given that franchise terms may run for as long as 10 to 15 years. At the time the franchise is negotiated, neither the franchising authority nor the cable operator can reasonably foresee what level of cable service will be technically and economically feasible, and that cable subscribers will have a right to expect, during the franchise term.

Cable operators could abuse such general upgrade requirements if the Commission permitted them to treat all upgrade costs as external costs. Often cable operators upgrade their systems to provide services that only a few cable subscribers may enjoy, or else to provide other new non-cable services that are not available to cable subscribers. Such upgrades may occur without the knowledge or agreement of the franchising

authority. Although these improvements may be described as "upgrades" of the overall cable system, these are not upgrades anticipated by, nor required by, franchising authorities.[3]

Moreover, cable operators often voluntarily agree to undertake an upgrade, or may be voluntarily undergoing an upgrade at the time of franchise renewal. The franchise may embody the cable operator's voluntary agreement to undertake such an upgrade. Cable operators should not later be able to point to such franchise language and argue that it is a franchise "requirement" which permits them to treat the cost of an upgrade as an "external" cost.

For the above and other reasons, cable operators should not be permitted to treat upgrade costs as an "external" cost merely because an upgrade provision is contained in a franchise.

Similarly, a cable operator that incurred upgrade costs prior to the effective date of rate regulation,

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[3] Moreover, the treatment of upgrade costs as external costs would unnecessarily increase the administrative burdens of rate regulation. Cable operators would engage in endless disputes with the Commission and franchising authorities over whether a capital expenditure or any slight improvement in the cable system is sufficient to qualify as an "upgrade" entitled to external cost treatment. Such disputes are better handled by requiring a cable operator to submit a cost-of-service showing in those extraordinary circumstances where the benchmark rate has not sufficiently taken such costs into account.

and that has a rate below that permitted by the benchmark chart, should not be treated differently than other cable operators that undertake upgrades. Local Governments strongly oppose the suggestion that such a cable operator automatically be permitted to raise its rates to the benchmark level and avoid any cost-of-service showing.[4]

II. Upgrade Costs Should Not Be Treated As External Costs

Regardless of whether required by a franchise, upgrade costs should never be treated as "external" costs. As Local Governments have recommended several times in this proceeding and the cost-of-service proceeding,[5] a cable operator should be able to recover upgrade costs only pursuant to a cost-of-service proceeding and only if the operator demonstrates it meets the conditions described below.

A cable operator should be permitted to submit a cost-of-service showing to recover upgrade costs only if it demonstrates special circumstances or extraordinary

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[4] See First Order on Reconsideration, Second Report and Order, and Third Notice of Proposed Rulemaking, In the Matter of Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation, MM Docket No. 92-266 at ¶ 145 (released August 27, 1993) ("NPRM").

[5] See, e.g., Comments of the National Association of Telecommunications Officers and Advisors, et al. in MM Docket No. 93-215 at 7-11 (filed August 25, 1993).

costs. The operator must demonstrate that its upgrade costs are extraordinarily high such that its revenue requirements substantially exceed revenues which would be generated through a proper application of the benchmark approach. Cost-of-service showings should be allowed only for the purpose of assisting an operator for whom rates calculated under the benchmark would be confiscatory because the operator has special circumstances that result in extraordinarily high, justifiable costs.

Finally, the cable operator would have to show that the extraordinary costs benefit all of the system's subscribers. This requirement is necessary to prevent cable operators from seeking to justify regulated rates above the benchmark that are based on upgrades for non-cable services (e.g., telephone services) or unregulated services (e.g., the provision of specialized or pay-per-view programming). For example, as a result of the Commission's September 23, 1993 decision permitting the provision of new personal communications services, cable operators can be expected to upgrade their cable systems to provide such services, despite the fact that most cable subscribers may not use, or benefit from, such services. Cable subscribers should not be forced to "cross-subsidize" personal communications services or other services that only a small number of subscribers

enjoy. System upgrade costs should only be recoverable if they improve service on the regulated tiers. Services that benefit only non-cable subscribers, or subscribers to premium, per-channel or pay-per-view services, should be paid for only by subscribers to such services.

If a cable operator meets the conditions recommended above for the recovery of "upgrade" costs, Local Governments support the proposal in the NPRM that franchising authorities have the right "to determine the way in which rates will be adjusted to reflect upgrade costs, including over what period of time such costs would be recovered, the operator's profit on the upgrade, and other issues involved in cost-of-service standards." NPRM at ¶ 154. Franchising authorities should have the right to ensure that such costs are recouped in a manner that balances the right of subscribers' to reasonable rates and cable operators' right to recover such costs. For example, cable subscribers should not have to suffer significant rate increases so that a cable operator can recover its upgrade costs in a short time period, when a more equitable solution would be more modest rate increases that would permit the cable operator to recover such costs over the life of a franchise term.

III. The Commission Should Require a Cable Operator to Submit the Same Rate Schedule in Both Basic and Cable Programming Service Tier Rate Proceedings, and Encourage the Sharing of Rate Information Between the Commission and Franchise Authorities

Local Governments support the Commission's tentative conclusion that cable operators should be required to elect either the benchmark or the cost-of-service approach for all regulated tiers.[6] Such a requirement is essential in order to prevent a cable operator from "gaming" the Commission's rules, and deciding that it may be more advantageous to submit a cost-of-service schedule in one rate proceeding, while submitting a benchmark schedule in the other. Moreover, if a cable operator were permitted to elect the benchmark approach for one service tier and cost-of-service for another, the operator would have an incentive, for example, to retier its services and place all of its low cost and cost free programming on the basic tier to which it would apply the benchmark method of regulation, while moving its most expensive programming to the tier for which it would apply a cost-of-service showing. Such actions by the cable operator

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[6] Local Governments are not opposed to permitting cable operators to switch from one method of regulation to another after a period of time. Local Governments believe that the minimum amount of time that a cable operator should be bound by its initial rate method is for one calendar year after the rate decision by the franchising authority or the Commission, whichever decision is made later.

would undermine the Commission's intention that the same "reasonable" rate determination be made on both basic and cable programming service tiers. Cable operators should not be allowed to "game" the Commission's rules in this manner.

Local Governments agree that the Commission should coordinate local and federal regulatory processes in order to reduce administrative burdens and costs if a cable operator submits a rate schedule, particularly a cost-of-service showing, to both the Commission and a franchising authority. Among other things, the Commission should require that whatever information a cable operator submits in one rate proceeding, it must submit in the other rate proceeding. Moreover, upon the request of the Commission, a franchising authority should submit to the Commission its rate decision and any information relevant to that decision. The Commission should submit the same information to a franchising authority upon the request of the franchising authority. In addition, the Commission should adopt rules that would facilitate consultations between the franchising authority and Commission staff reviewing the rates of a particular cable operator.

Local Governments would oppose any requirement that a decision by the Commission be binding on a franchising authority, or vice versa. Although the

Commission's rules should result in a similar reasonable per channel rate for the basic and cable programming service tiers, there may be a difference in the actual appropriate reasonable rates for such tiers. Such difference may be attributable to differences in "external" costs for the tiers, or the fact that the costs for one tier may be lower than the costs for another. Hence, a decision by the Commission as to the appropriate rate for a cable programming service tier may not be entirely applicable to the rate decision a franchising authority must make for the basic service tier.

Moreover, rate decisions by the Commission that would bind a franchising authority's review of basic rates would violate Section 623 of the Cable Television Consumer Protection and Competition Act of 1992 ("1992 Cable Act"). See 47 U.S.C. § 543(a) ("the rates for the provision of basic cable service shall be subject to regulation by a franchising authority . . .; and the rates for cable programming service shall be subject to regulation by the Commission"). As the Commission noted, Congress in the 1992 Cable Act gave "local franchising authorities primary authority over basic

service rates and the FCC exclusive authority over rates for cable programming services." FNPRM at ¶ 87.[7]

However, Local Governments agree that the Commission should take steps to coordinate local and federal rate decisions and reduce the administrative burdens of duplicative rate regulation. Consistent with that goal, a cable operator should be required to demonstrate compelling reasons to the franchising authority as to why it should not be bound by a rate decision by the Commission, and vice versa. The franchising authority, in its sole discretion, should have the right to adopt and apply the Commission's rate decision, if appropriate, or to make a different rate decision consistent with the Commission's rules. Similarly, the Commission could adopt a franchising authority's rate decision or make a different rate decision.

IV. The Commission Should Adopt a Method of Adjusting Capped Rates as a Result of Channel Changes That Is Simple to Use and Ensures Reasonable Rates

Local Governments agree that the Commission must adopt a method of adjusting capped rates following a deletion or addition of channels. However, consistent

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[7] To the extent that franchising authorities and the Commission systematically reach different decisions on certain issues, the Commission should consult with representatives of franchising authorities, or institute further rulemaking proceedings, so that such differences may be resolved.

with two major goals of the 1992 Cable Act, such a method: (1) should ensure that cable subscribers continue to pay reasonable rates following channel deletions or additions, see, e.g., 47 U.S.C. § 543(b)(1); and (2) should not be unduly burdensome for franchising authorities and the Commission to administer, see, e.g., 47 U.S.C. § 543(b)(2)(A).

With these goals in mind, the Local Governments oppose the Commission's tentative conclusion that it should adopt an approach which would require that the new permitted per channel rate following a deletion or addition of channels be the existing permitted per channel rate adjusted for programming expense and adjusted to reflect the same proportionate per channel rate increase or decrease observed in the benchmark rate. NPRM at ¶ 139. This method appears to be unduly complicated, and would not be easy to administer. Moreover, Local Governments are concerned that the approach may be manipulated by cable operators, in their calculation of programming costs, to pass through retransmission consent costs and other costs not attributable to the addition of new channels.

Local Governments urge the Commission to adopt the alternative that would require that the new permitted rate for a regulated tier with added or deleted channels be the benchmark per channel rate based

on the new number of channels on the system multiplied by the number of channels on the tier. NPRM at ¶ 138. This alternative should be easier for franchising authorities and the Commission to administer and is consistent with the benchmark methodology. However, to ensure that the rate is reasonable, the Commission should develop a method to adjust such a new benchmark rate to account for rate adjustments made in the past as a result of external costs or a cost-of-service submission. For example, if the Commission, as a result of a cost-of-service submission, previously ordered a cable operator to reduce its rates to a rate below the then-permitted benchmark rate, the new benchmark rate should be adjusted to reflect such a rate reduction so that cable subscribers do not lose the benefit of such a rate reduction. Otherwise, the new permitted benchmark rate may entitle the cable operator to charge rates higher than that justifiable under its previous cost-of-service showing, after taking into account that new channels are being added to the system.

CONCLUSION

For the foregoing reasons, the Commission should: (1) not treat the costs of upgrades as "external costs," regardless of whether required by a franchise agreement or if incurred prior to the commencement of rate

regulation; (2) require that cable operators apply the same rate method (cost-of-service versus benchmark) in both federal and local rate proceedings; and (3) adopt a method for adjusting a capped rate following the addition or deletion of channels that ensures reasonable rates and that is easy to administer by the Commission and franchising authorities.

Respectfully submitted,

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